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ZAIRE: Swallowing The "Bitter Pill" Of Economic Reform [redacted]

Summary

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Faced with chronic economic problems, Zaire has been making a strong effort this year to stick to its latest economic stabilization program. The country has been experiencing economic and financial difficulties almost continuously since 1974 and has had limited success with a series of earlier corrective economic measures. Kinshasa is a long way from achieving economic stability and will have to maintain strict economic adjustment policies for several years to attain that goal. Expected low levels of new investment and continued foreign exchange shortages promise slow economic growth for the rest of the decade. [redacted] 25X1

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Mixed Results in 1983

Following a dismal 1982 economic performance of negative economic growth, a near record current account deficit of $432 million, and the virtual exhaustion of foreign exchange reserves, Kinshasa introduced a number of stronger measures last year to halt the economic and financial deterioration. These measures, programmed for 1983-84, were intended to

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This memorandum was self-initiated by [redacted] Regional Issues Branch, Africa Division, Office of African and Latin American Analysis. Questions and comments are welcome and may be directed to the Chief, Africa Division, ALA, [redacted] 25X1

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smooth the way for a new IMF standby arrangement for balance of payments support. Kinshasa's actions anticipated restrictive conditions that the IMF would, most likely, have required later. The measures included:

-- a massive 77 percent devaluation last September of the zaire in terms of the IMF's Special Drawing Right (SDR).

-- a floating exchange rate and the temporary establishment of a dual exchange rate system of official and free (parallel) market rates in September 1983 as a transition to a unified exchange rate. (The two rates were unified in March 1984).

-- a program of fiscal austerity, with strengthened budgetary controls and tax reform. A new fiscal regime was introduced for GECAMINES, again in September, partly with a view to rationalizing the important revenue flow of that mining parastatal to the Zairian treasury.

-- liberalization of the trade and exchange system by easing, for example, restrictions on trade in artisanal gold and diamonds; by removing restraints on commercial bank retention of foreign exchange receipts; and by simplifying import licensing regulations.

-- extensive liberalization of consumer prices and of producer prices for agricultural products. [redacted] 25X1

Zaire's economic stabilization measures substantially contributed to a halt in its economic and financial decline last year. Export volume increases for cobalt, zinc, diamonds, and crude oil also helped. The foreign trade surplus rose to $410 million, up from $326 million in 1982. Real GDP grew by 0.5 percent, after a 2 percent fall the previous year. The budgetary deficit was reduced to 2 percent of GDP, compared to 9 percent in 1982. The current account deficit fell by $112 million to $320 million. [redacted] 25X1

Some negative developments clouded the economic picture. The inflation rate was 76 percent, compared to 37 percent in 1982, mainly because of the currency devaluation and the accompanying higher domestic prices for imported petroleum, which were reflected in higher public utility rates for electricity and public transport. Activity in the agricultural sector was disappointing, with a poor performance by cash crops. Production of coffee, Zaire's chief agricultural export, was down 21 percent; palm kernel, 30 percent, sugar cane, 21 percent; and rubber and tea, 7 percent each. [redacted] 25X1

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More Debt Rescheduling

In a recurring scenario that first appeared in 1976, Zaire, last December, once again obtained relief on its external debt. Although this relief has eased somewhat the pressure on the country's balance of payments, the payments situation remains tight. [redacted] 25X1

In its evaluation of Zaire's 1983-84 economic program the IMF regarded debt relief as a precondition for its approval of a new standby arrangement. Kinshasa's heavy debt service obligations, which already had sizeable arrears, threatened to contribute to external financial gaps that were not consistent with the program presented. At yearend 1982, Zaire's official and officially guaranteed debt stood at $4.4 billion, of which $2.5 billion was owed to Paris Club creditors (certain governments) and $350 million to London Club creditors (certain commercial banks). Arrears of debt service obligations were nearly $700 million, with an additional $220 million overdue for imports and invisible trade. [redacted] 25X1

Zaire's success in rescheduling some $920 million of Paris Club debt obligations in December 1983 enabled the present 15-month IMF standby arrangement to become effective later that month. The standby will provide some $240 million in balance of payments support in installments, subject to periodic review of agreed on performance criteria. In addition, Kinshasa received a $122 million loan last December from the IMF's Compensatory Financing Facility, for previous shortfalls in export earnings. [redacted] 25X1

The 1984 Adjustment Program

Zaire's 1984 economic adjustment program focuses on improved financial management under a regime of fiscal austerity. The key objectives are:

- -- curbs on the budgetary deficit
- -- a reduction in the rate of credit expansion in the economy
- -- removal of excess liquidity from the banking system
- -- the establishment of a money market to help absorb domestic currency and reduce the demand for foreign exchange, and
- -- further development of the interbank foreign exchange market. [redacted] 25X1

Kinshasa has successfully undergone two IMF reviews of performance criteria this year, for the periods ending December 1983 and March 1984. The review for the June 1984 quarter is scheduled for this month and the

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preliminary indications are that Kinshasa will again be in compliance with the IMF's conditions. [redacted] 25X1

In the course of the IMF reviews, Zaire has been able to obtain minor waivers of performance criteria or slight modifications in its program because of mitigating circumstances. Such changes were anticipated by the IMF and by the Zairian authorities themselves. For example, waivers on ceilings for the banking system's net credit to the government and to the private sector at yearend 1983 were obtained after inproved methods for compiling monetary statistics, implemented after the 1983-84 program was prepared, revealed that the ceilings had been exceeded. Also, on the basis of the IMF review for first quarter 1984, programmed public and private sector borrowing has been eased somewhat to deal with an anticipated tight liquidity situation and to accommodate increased Treasury financing now required by the program. [redacted] 25X1

No Vigorous Economic Performance This Year

In our estimation, Zaire's economic performance this year will not be a vigorous one. This is not unexpected, in view of tight fiscal and monetary policies in an economic program that emphasizes longer-term stability over short-term economic expansion. We expect marginal growth in GDP this year, between 1 and 2 percent. [redacted] 25X1

In the international accounts, the foreign trade balance should show some slight improvement. Prices for cobalt, zinc, and coffee are climbing and higher export volumes are expected for cobalt, diamonds, and crude oil. Copper production by GECAMINES through mid-year has been on target at its production capacity of 470,000 metric tons annually. Copper prices are on the rise, although still below last year's average. Imports, on the other hand, should rise marginally under the austerity regime. The current account deficit will likely widen by some $20 million, mainly from increased interest payments on external debt owing to non-Paris Club creditors. [redacted] 25X1

Stabilization Plans Remain on Course

Zairian President Mobutu and his principal economic advisers, including Prime Minister Kengo Wa Dondo and Bank of Zaire Governor Sambwa Pida, have shown unusual resolve this year in implementing the economic reforms. In addition, the country has been meeting its newly negotiated debt service obligations. Agreed on monthly deposits in the Federal Reserve Bank of New York for the benefit of Paris Club creditors have been made on schedule. A payments program has been worked out with London Club creditors. All prior arrangements for the reduction of commercial and invisible trade arrears through cash payments in foreign exchange have been complied with, so far. [redacted] 25X1

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The economic reform measures go much beyond those previously undertaken. In the process of strengthening budgetary controls an increasing number of government operations have been centralized under the Ministry of Finance. A comprehensive listing of government employees, compiled for the first time, will tend to eliminate payments for non-existent workers at the same time that the government seeks to control a salary mechanism that preempts some 25 percent of government receipts. 25X1

The June 1984 dissolution of SOZACOM, the parastatal marketing agency for GECAMINES, has been an additional important move toward greater financial responsibility. The elimination of the marketing middleman should improve the timeliness of copper export receipts by GECAMINES and of payments by GECAMINES to the Zairian Treasury. In addition, a major source of leakages of foreign exchange receipts, through unaccounted for minerals sales through SOZACOM, has been removed. 25X1

The Longer View

Zaire's economic problems do not lend themselves to an early solution. Even with continued resolve by the Zairian authorities serious obstacles to economic recovery remain. 25X1

-- The inflation rate, expected to be around 50 percent this year, needs to be brought under control rapidly. If not, continued depreciation of the Zairian currency will put upward pressure on prices and wages. This depreciation could also fuel a revival of the parallel foreign exchange market and cripple an important element of the recovery program--the establishment of an official exchange rate process that reflects Zaire's costs and prices. 25X1

-- Much of the economic recovery program depends on the ability of GECAMINES to maintain its productive capacity and, consequently, its key contributions to foreign exchange earnings (about 80 percent) and to the already tight government budget (about 22 percent this year). In the course of maintaining productive capacity in the recent past GECAMINES has postponed capital investment and has fallen behind in removing the overburden of the open pit mines at Kolwezi that supply 60 percent of its copper. GECAMINES now urgently needs capital for plant rehabilitation. To further complicate the maintenance of productive capacity, the deteriorating rolling stock of SNCZ, the national railroad, may not be able to move sufficient copper concentrates from mines to refineries. 25X1

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-- Agricultural production will likely continue to be restrained by the shortage of investment funds, both for agricultural projects and for improving the domestic transport network necessary for moving crops to markets. World Bank funds are available for railroad and road improvement projects in both agriculture and mining, but the required counterpart funds are hard to come by in a regime of budget stringency. [redacted] 25X1

-- Debt service payments will continue to keep Zaire in a financial straitjacket that will leave little room for applying new resources to economic growth. Even with the latest rescheduling, debt service consumes 50 percent of government expenditures, with Zaire's total debt at the end of 1983 an estimated $5.2 billion, including commercial debt. The IMF believes that, for future economic programs to be viable, debt rescheduling will be required each year for the rest of the decade. [redacted] 25X1 [redacted] only a small proportion of Zaire's 25X1 debt principal will ever be recovered. [redacted] 25X1

The Political Fallout

Despite its austerity, we do not see Zaire's economic adjustment program having any adverse political fallout for President Mobutu even if maintained, as appears necessary, for several years. There may be future protests by mineworkers, students, and civil servants, but Mobutu remains firmly in control, after his election this month to a third seven year term. Zaire's living standards have been falling for nearly a decade and the majority of the population has apparently adopted a fatalistic attitude toward hard times. Although there are some 50 anti-Mobutu groups inside and mostly outside Zaire we believe that none of them are influential enough to provide a serious challenge, or alternative, to the present regime. [redacted] 25X1

President Mobutu has apparently resigned himself to swallowing the self-described "bitter pill" of economic reform, with its requirement of rigorous and more honest economic and financial management. Even if sustained economic adjustment programs eventually succeed in turning the Zairian economy around, however, aspects of the present regime will continue to prevent the country from realizing the full economic potential of its rich endowment of natural resources. These negative attributes include pervasive corruption at high levels, a concentration of power in Mobutu that stifles administrative initiative in the government, and the official practice of favoritism to special interest groups and regions at the expense of the national economy. [redacted] 25X1

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Table I

ZAIRE: Current Account

Million US $	1981 (a)	1982 (a)	1983 (a)	1984 (b)
Current account balance	-424	-432	-320	-338
Trade balance	210	326	410	465
Exports f.o.b.	1500	1454	1523	1642
Copper	757	791	781	778
Imports f.o.b.	1290	1128	1113	1177
Oil	249	187	171	194
Net services and transfers	-634	-758	-730	-803

a. Estimated.
b. Projected.

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Table II

Zaire: Selected Economic Adjustment Measures in the Present Economic Recovery Program

Economic Adjustment Measures	Implementation Status
Devaluation of the zaire by 77.5 percent in terms of the SDR.	September 1983
Floating of the zaire and introduction of a temporary dual exchange rate arrangement.	September 1983
Adoption of a new fiscal regime for GECAMINES	September 1983
Liberalization of all domestic retail prices.	September 1983
Rescheduling of official debt to Paris Club	December 1983
Establishment of a blocked Bank of Zaire account for handling external debt service payments	January 1984
Unification of official and free market exchange rates	January 1984
Auctioning of Treasury Bills as part of creating a domestic money market	June 1984
Substantial reduction in customs duties	Incomplete
Comprehensive listings of government employees	Believed incomplete

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Table III

Zaire: Composition of Exports, 1982 (Percent)

Copper	40.4
Cobalt	6.6
Diamonds	11.7
Coffee	18.9
Other	22.4
	100.0

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Table IV

Zaire: Selected Economic Indicators

	1980	1981	1982	1983	1984 (a)
Real GDP Growth (Percent)	2.4	2.4	-1.0	0.5	1.5
Consumer Price Changes (Percent)	47	35	37	76	49
Copper Export Volume (Percent change)	37	12	5	-6	-4
Debt Service Ratio as percent of exports of goods and services	22	25	18	18	27

a. Projected.

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